BEFORE THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE PROTEST OF
DAVID HAWKINSON **No. 97-09**
PROTEST TO ASSESSMENT NO. 640185

DECISION AND ORDER

This matter came on for hearing on February 11, 1997, before Ellen Pinnes, Hearing Officer. David Hawkinson ("the Taxpayer") appeared on his own behalf. The Taxation and Revenue Department ("the Department") was represented by Gail MacQuesten, Special Assistant Attorney General.

Based upon the evidence and arguments presented, IT IS HEREBY DECIDED AND ORDERED AS FOLLOWS:

FINDINGS OF FACT

1) The Taxpayer moved to New Mexico from Tennessee in 1990 to take a new job in New Mexico. The Taxpayer became a resident of New Mexico in 1990 and was a New Mexico resident throughout 1991.

2) As part of his employment agreement with his new employer, the Taxpayer was reimbursed by the employer for certain moving expenses incurred in connection with relocation to New Mexico. The Taxpayer received reimbursement for moving expenses in 1991; this payment was reported by the employer as compensation to the Taxpayer on the Form W-2 for that year. (See Ex. 4.)

3) The moving expense reimbursement was included in the figure for total compensation shown in block 10 of the W-2. When the total was broken out, the relocation reimbursement was reported in block 18 of the W-2 ("other"), separately from the amount shown in block 25 as "state wages". Because the moving expense reimbursement was reported

separately from "state wages", the Taxpayer believed that the reimbursement was not taxable income for New Mexico state tax purposes.

4) In reporting his 1991 income to New Mexico, the Taxpayer carried over the figure for taxable income shown on line 37 of his federal tax return, as directed by the instructions for line 8 of the state personal income tax form. However, he deducted from that amount the $23,628.00 reimbursement for moving expenses, and entered the resulting figure of $34,752.00 in line 8 of the state return. The Taxpayer included a handwritten notation on the face of the PIT-1 income tax form filed with the Department, explaining that he had deducted this amount from the taxable income figure shown on his federal return, and noting that this amount was "fed[eral] only". (See Ex.3.)

5) The Department's usual practice when a tax return is filed with an added notation is for the person processing the form to bring the return and notation to the attention of a supervisor. If the supervisor determines that the change made by the taxpayer is not a valid adjustment, the return is sent back to the taxpayer with notice that the adjustment is incorrect and is being rejected. For unknown reasons, this procedure was not followed with regard to the Taxpayer's 1991 income tax return.

6) Pursuant to a tape match (a computer check in which it is determined whether line 8 of a taxpayer's state income tax return matches the taxable income amount shown on the taxpayer's federal return), the Department later became aware that the amount of income reported by the Taxpayer for federal tax purposes in 1991 differed from that reported to the Department for state tax purposes.

7) New Mexico's income tax reporting system "piggybacks" on the federal reporting system. Thus, a taxpayer takes the figures calculated for adjusted gross income and taxable income on his federal return and transfers them to his state return in order to begin the process of determining the amount of state income tax owed. The state forms then provide for deduction of amounts that may be deducted under state law but not on the federal return. This allows for calculation of the amount of state taxable income on which state income tax is computed. (See

Ex. 3.)

8) Because the New Mexico system piggybacks on the federal return, the amount shown on the lines for federal taxable income on the federal return and the state return should be identical. In this case, they were not identical, as the Taxpayer had deducted the amount of the moving expense reimbursement from the amount shown as taxable income on the federal return, because he believed that it was subject to federal income tax but not to New Mexico state income tax.

9) After the discrepancy between the Taxpayer's federal and state returns was discovered, the Department recomputed the Taxpayer's 1991 state income tax and on September 29, 1995, issued assessment No. 640185 for $1,436.00 in income tax owed for 1991, plus penalty and interest.

10) The Taxpayer filed a timely protest of the assessment by his letter dated October 24, 1995.

11) At the commencement of the hearing, the Department announced that the penalty would be abated. Accordingly, this matter involves the propriety of the assessment only insofar as it concerns income tax and interest.

12) The total amount of the payment for moving expenses that the Taxpayer received from his employer was $23,628.00. Part of this sum was paid to the Taxpayer to reimburse him for expenses incurred, while part of it was paid directly to vendors providing services to the Taxpayer in connection with the move. The employer's payment covered such expenses as moving of household goods and personal effects, meals and lodging while en route from Tennessee to New Mexico and before the Taxpayer found a permanent home in Albuquerque, and charges associated with sale of the Taxpayer's Tennessee residence and acquisition of a residence in New Mexico.

13) The Taxpayer originally deducted the full $23,628 from the amount reported as federal taxable income, in filing his 1991 state tax return. He now concedes that most of this amount is properly subject to state tax in New Mexico. He continues to challenge inclusion in

his New Mexico taxable income of that portion of the payment that reimbursed him for a portion of the commission paid to the realtor in Tennessee who handled the sale of the Taxpayer's Tennessee residence.

14) Of the $23,628.00 moving expense reimbursement, $9,396.00 was a partial reimbursement of the $14,400.00 commission paid to the Tennessee realtor for services in connection with sale of the home in Tennessee. These services were performed in Tennessee beginning in 1990 and continuing through the time the sale was finalized in 1991. The Taxpayer was not reimbursed for the full amount of the commission because his total moving expenses exceeded the cap on expenses reimbursable by the employer.

15) It is not clear whether the Taxpayer deducted the expense reimbursement at issue here for federal tax purposes. No copy of the Taxpayer's federal tax return was produced at the hearing. The Taxpayer testified that he reported moving expenses of $16,833.00 on the Schedule A (itemized deductions) on his 1991 federal tax return.

DISCUSSION

The Taxpayer challenges the Department's assessment on two grounds:

1) that no New Mexico income tax should be due on monies received by the Taxpayer to reimburse him for moving expense, including a real estate commission paid to a person outside New Mexico, for services performed outside New Mexico, and

2) that is was unfair to assess taxes in 1995, and impose interest thereon, when he had clearly identified for the Department the adjustment made on his 1991 tax return, so that any error could have been detected and corrected earlier.

Assessment of tax on reimbursement for relocation expenses

The Taxpayer originally deducted from state taxable income the entire $23,628.00 paid by his employer for moving expenses incurred in connection with relocating from Tennessee to New Mexico for his new job. This was based on his belief that the reimbursement, which was

separated out from "state wages" on the W-2 provided to the Taxpayer by his employer, was not subject to New Mexico tax.

At the hearing, the Taxpayer conceded that the majority of this amount was taxable by New Mexico. However, he argued that the $9,396.36 paid by his employer as partial reimbursement of the commission paid to the real estate agent who handled the sale of his Tennessee home should not be taxable in New Mexico because it was paid to a person outside this state, for work done entirely in another state, and beginning well before the tax year in question.

The New Mexico Income Tax Act defines "compensation" to include "wages, salaries, commissions and *any other form of remuneration* paid to employees for personal services". §7-2-2(C) NMSA 1978, emphasis added. Here, the Taxpayer's employer paid for the Taxpayer's expenses in relocating from Tennessee to New Mexico as part of the compensation paid to him in connection with his work for the employer. The moving expense reimbursement therefore falls within the Income Tax Act's definition of compensation, and was so reported on the W-2 form issued to the Taxpayer by his employer for 1991.

Because the Taxpayer was a New Mexico resident in 1991, the compensation was properly allocated to New Mexico for tax purposes. TRD Regulation IT 11:6 ("[a]ll compensation received while a resident of New Mexico shall be allocated to this state whether or not such compensation is earned from employment in this state"). The fact that the expense being reimbursed was incurred in Tennessee is irrelevant.

New Mexico income tax is imposed upon the "net income" of New Mexico residents. §7-2-3 NMSA 1978. The starting point for determining net income is a taxpayer's "base income", which is defined as the amount of "adjusted gross income" determined under the federal Internal Revenue Code. §7-2-2(A),(B)(2). Net income is a taxpayer's base income, adjusted as provided in the Income Tax Act. §7-2-2(N). Those adjustments include amounts allowed as deductions to a taxpayer under the Internal Revenue Code.

This state statutory scheme is reflected in the New Mexico personal income tax forms,

which "piggyback" on the federal return by directing taxpayers to transfer figures for adjusted gross income and taxable income directly from the federal form. (See Ex. 3.) Any deductions from income properly allowed at the federal level thus already will have been taken and will be reflected in the taxable income shown on the New Mexico return.

New Mexico does not allow a deduction for moving expenses incurred in connection with relocation to a new job. Such a deduction is permitted under federal law. 26 U.S.C. §217(a). If a taxpayer takes the deduction at the federal level, the income figures transferred to the state return for computation of state taxes will be those calculated after the deduction, and no state tax is imposed on the amount deducted.

The record here does not establish whether the Taxpayer availed himself of the full deduction possible under federal law. The Taxpayer testified that he included $16,833.00 of moving expenses in itemized deductions on his federal tax return for 1991. If the income at issue here was deducted on the federal return, no state tax was imposed on it, because that amount had already been removed from his taxable income. It cannot be deducted a second time.

Whether the Taxpayer actually took the deduction on his federal tax return is irrelevant to the issue presented here. New Mexico income tax is imposed on the Taxpayer's net income after deduction of amounts allowed under federal law. See §7-2-2(N). If the Taxpayer did not take the deduction when he computed taxable income at the federal level, there is no provision for him to do so at the state level.

The Department thus properly assessed the Taxpayer for New Mexico income tax on the moving expense reimbursement amount improperly deducted on the 1991 state tax return.

Assessment of taxes for 1991 pursuant to a 1995 tape match

The Taxpayer clearly noted on the face of his 1991 New Mexico state tax return that the reimbursement received from his employer for moving expenses was being subtracted from the federal taxable income figure for state tax purposes. In accordance with its usual practice, the Department should have reviewed the notation and, if it disagreed with the exclusion, sent the

return back to the Taxpayer for correction. Had this practice been followed here, the Taxpayer could have corrected the error promptly, and little or no interest would have accrued. Because the Department did not follow this procedure, the error was not detected until it was picked up on a tape match some years later, and the Taxpayer was assessed interest on underpaid tax at the statutory rate of 15% per year.

Under the New Mexico Tax Administration Act, the Department has three years from the end of the calendar year in which a tax is due to issue an assessment for the tax. §7-1-18(A) NMSA 1978.[1] The Taxpayer's personal income tax return for 1991 was due in 1992, §7-2-12 NMSA 1978, and the Department therefore had until December 31, 1995 to issue an assessment. The Department's September 1995 assessment for underpayment of the tax was therefore timely under the statute. Because the assessment of tax was proper, interest on the deficiency was also proper. (See discussion below.)

The Taxpayer (who is not a lawyer) has not specifically argued for estoppel. However, his assertion of unfairness can be read to raise such an issue. Accordingly, it is discussed here.

The Tax Administration Act expressly provides for estoppel against the Department where a taxpayer acted in accordance with regulations or with a departmental ruling addressed personally to the taxpayer. §7-1-60 NMSA 1978. The Taxpayer here makes no claim that he acted in accordance with applicable regulations or any ruling. Statutory estoppel therefore does not apply.

Although the Department's assessment here is not barred by statutory estoppel, the Department may be estopped on equitable

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[1] This limitation period is extended in certain circumstances. Because the assessment in this case is within the three-year period provided in subsection A of §7-1-18, whether those circumstances exist is not at issue here.

principles. Equitable estoppel will be applied against the state when right and justice demand it. See *Gonzales v. Public Employees Retirement Board*, 114 N.M. 420, 427, 839 P.2d 630 (Ct.App. 1992), *cert. den.* 8/14/92. However, the state will be held to be estopped only rarely, especially where taxes are at issue. *Taxation and Revenue Department v. Bien Mur Indian Market Center*, 108 N.M. 228, 231, 770 P.2d 873 (1989).

In order to establish an estoppel, the following elements must be shown as to the party to be estopped: 1) conduct amounting to a false representation or concealment of facts, 2) actual or constructive knowledge of the true facts, and 3) an intention or expectation that the other party will act on the representation. The party asserting an estoppel must show: 1) lack of knowledge of the true facts, 2) reasonable reliance on the representations, and 3) detriment if the party to be estopped is allowed to assert the true facts. *Gonzales, supra*, 114 N.M. at 427.

Here, the Department failed to catch the Taxpayer's error in reporting his taxable income for state tax purposes, despite the fact that he expressly called the Department's attention to the manner in which he calculated that income. While this was unfortunate, it does not rise to the level of conduct amounting to a false representation or concealment of facts, and thus fails to satisfy the first element of estoppel.

Moreover, the Taxpayer has not shown detrimental reliance on any conduct of the Department. He does not argue that his original error in reporting his income was made in reliance on any action or inaction of the Department, nor has he shown that the Department

in any way prevented him from discovering the error. Based on the facts presented here, the Department is not estopped to assess the underpaid tax, plus applicable interest.

Interest

Section 7-1-67 NMSA 1978 provides for the imposition of interest on tax deficiencies:

> A. If any tax imposed is not paid on or before the day on which it becomes due, *interest shall be paid to the state on such amount* from the first day following the day on which the tax becomes due ... until it is paid ... .
> B. Interest due to the state under Subsection A ... *shall be at the rate of fifteen percent a year* ... . (Emphasis added.)

It is a well settled rule of statutory construction that the word "shall" is mandatory rather than discretionary, unless a contrary legislative intent is clearly demonstrated. *State v. Lujan*, 90 N.M. 103, 560 P.2d 167 (1977). The New Mexico Legislature has expressly reiterated this general rule in §12-2-2(I) NMSA 1978 (in construing statutory provisions, the words "shall" and "must" are to be construed as mandatory unless this would be inconsistent with manifest legislative intent or repugnant to the context of the statute).

Section 7-1-67 requires that interest, at the rate of 15% per year, be imposed on the amount of any unpaid taxes. No exceptions to this rule are provided for. Interest is intended to compensate the state for the time-value of money which was not paid when it was due. It may be unpleasant to pay interest on monies owed, particularly where the taxpayer is for some time unaware of the existence of the debt, as was the case here. However, interest is not a penalty for late payment. It is, rather, a means of making

a creditor whole through reimbursement for not having had the use of the money during the time it remained unpaid. While the interest rate imposed here may seem high, that rate has been set by the Legislature in the statute, and both the Department and the hearing officer lack the authority to reduce it.

The Taxpayer here acted in good faith. He believed that he was acting in compliance with the requirements of the Income Tax Act, and he did his best to alert the Department to the basis for his actions so that any error could be promptly corrected. It is unfortunate that the Department did not notice the Taxpayer's notation on his tax return so as to allow for a more timely correction. However, the interest assessed is mandated by statute and cannot be abated.

Doctrine of equitable recoupment

The Taxpayer did not raise an issue of equitable recoupment at the hearing. However, the Department noted that counsel representing the Taxpayer in an earlier stage of the proceedings had argued that the assessment at issue was barred by this doctrine. Accordingly, it is briefly addressed here.

The doctrine of equitable recoupment states that where a single taxable event is subjected to tax on inconsistent legal theories, the amount mistakenly paid on the original theory must be credited against the amount ultimately determined to be due, even if the time for seeking a refund of the earlier payment has passed. That is, if a taxpayer has paid tax on a transaction under one view of the facts and law, the government cannot impose tax on the same transaction under a different view without giving the taxpayer credit

for the initial amount paid. *Vivigen, Inc. v. Minzner*, 117 N.M. 224, 220-30, 870 P.2d 1382 (Ct.App. 1994).

The doctrine does not apply here. The Department is not taxing the Taxpayer's 1991 income twice under varying legal theories. Rather, the assessment here is based on inclusion of additional income on which tax was not paid earlier. There is no change in the legal theory on which the Department is imposing the tax, and the amount originally paid by the taxpayer for 1991 has been credited toward his total tax bill for that year. The assessment here is for the balance due above the amount already paid.

CONCLUSIONS OF LAW

1) The Taxpayer filed a timely protest of Assessment No. 640185. Jurisdiction thus lies over the parties and the subject matter of this protest.

2) The Department has abated the penalty assessed against the Taxpayer. The validity of the penalty therefore is not before the hearing officer for decision.

3) The Taxpayer improperly deducted the relocation expense reimbursement received from his employer from his taxable income for state income tax purposes, and the Department's assessment for tax due based on this additional income is proper.

4) Because the Taxpayer did not pay the tax owed at the time it was due, interest was properly imposed on the deficiency at the statutory rate.

5) The Department is not estopped to collect either the underpaid tax or interest thereon.

6) The assessment is not barred by the doctrine of equitable recoupment.

For the foregoing reasons, the Taxpayer's protest IS HEREBY DENIED.

DONE, this 13th day of March, 1997.